Statement of Case.

In 1926 Petitioners' predecessors in title leased premises located at Trenton, New Jersey, to the Debtor for a term of twenty years under a lease containing the following provision:

> "* * * these presents are upon this covenant, that if the Tenant * * * shall be adjudicated bankrupt or insolvent according to law, or if any assignment of its property shall be made for the benefit of creditors, then and in any of said cases the Landlord lawfully may enter into and upon the said premises * * * without being deemed guilty of any manner of trespass, and without prejudice to any remedies which might otherwise be used for arrears of rent or preceding breach of covenant, and upon entry as aforesaid this lease shall determine and the Tenant covenants that in case of such termination it will indemnify the Landlords against all loss of rent which the Landlords may incur by reason of such termination, during the residue of the term above specified" (R. 57-58).

The Debtor was adjudicated a bankrupt on August 29, 1932. The Debtor's Trustee in Bankruptcy disaffirmed the lease on November 14, 1932. Thereupon, Petitioners reentered the premises (R. 40-41). This re-entry terminated the lease (Petitioners' Brief, p. 6).

On June 14, 1934, the filing by the Debtor of its petition for reorganization under Section 77-B of the Bankruptcy Act was approved (R. 40). The Petitioners filed a claim in these proceedings for $90,212.91, being the alleged rent payable under the lease, including estimated taxes, for the residue of the term specified, less the alleged rental value (as of August 29, 1932) for the same period (R. 6-7, 73-74).

The Debtor's Trustee objected to the claim as filed and asked that it be limited to an amount limited by the statute. Upon the hearing the Trustee conceded that the Petitioners' damages would equal the statutory maximum (R. 19).

The Preferred Stockholders Committee and the Debentureholders Committee (intervenors in the proceedings) objected

to the allowance of the claim in any amount over the rental due at the termination of the lease for the reason that it was uncertain whether the Landlords would suffer any loss (R. 20-21). The evidence presented on behalf of the Petitioners as to the re-rental value of the premises was objected to as irrelevant and immaterial (R. 21), and evidence was presented to show that there was no reason to believe that the rental value of the premises was permanently impaired. Specifically, this evidence showed that the premises covered by the lease are located in the business center of Trenton, New Jersey, and are desirable for any retail business, and that so far as can be determined the location will continue to be one of the best locations in that city (R. 29-37).

The Special Master recommended that the claim should be allowed as a general claim in the amount of $44,377.55 (being an amount equal to three years' rent, including taxes, from the date of the Landlords' re-entry upon the premises, plus the rent and taxes which had accrued to the time of such re-entry), but that all questions as to the excess of their claim should be reserved until the time of the classification of creditors and stockholders according to the nature of their respective claims and interests, and the consideration of a plan of reorganization (R. 93).

The District Court (Knox, J.) confirmed the allowance of the claim in the amount of the statutory maximum, but held that such maximum was the extent of the Petitioners' right to participate in these proceedings (R. 116-118). The Court of Appeals affirmed the order of the District Court.

Petitioners appeal from so much of the order as limits their claim to $44,377.55 and argue that the provision of Section 77-B of the Bankruptcy Act, which limits the amount for which future rent claims may be proved, is unconstitutional.

Statute Involved.

Section 77-B (b) (10) provides in part as follows:

> "The claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be treated as a claim ranking on a parity with debts which would be provable under section 63 (a) of this act, but shall be limited to an amount not to exceed the rent, without acceleration, reserved by said lease for the three years next succeeding the date of surrender of the premises to the landlord or the date of re-entry of the landlord, whichever first occurs, whether before or after the filing of the petition; plus unpaid rent accrued up to such date of surrender or re-entry * * *."

Summary of Argument.

This brief will be devoted to consideration of the constitutionality of the statute. The memorandum opinion of the District Court admirably summarizes the argument in support of the statute.* Judge Knox said:

> "In my opinion, the provisions made by Section 77 b for the allowance of claims of landlords upon breached real estate leases were intended to put at rest the interminable speculative considerations that had to be taken into account in arriving at damages growing out of broken leases. In a proposed reorganization it is essential that claims be known and fixed at an early date—it is better that damages be fixed arbitrarily, as was done, than they should depend upon the attempts of parties in interest, assisted by experts, to read the future" (R. 146).

---

* No appeal has been taken to this Court from the allowance of the claim for the amount equal to the three year maximum, although in the courts below we urged that the Petitioners are not holders of a claim which may be presently liquidated.

I.

The limitation imposed by Section 77-B of the Bankruptcy Act upon contingent rent claims is reasonable and constitutional.

The Petitioners would seem to be "creditors" under the broad definition of that term contained in Section 77-B (b) (10) and the provision of the statute quoted above evidences an intention that some valuation should be placed upon the contract right of the Petitioners for the purposes of a plan of reorganization terminating the Debtor's liability under such contract. The compensation to be allowed for the termination of the Petitioners' right must depend, however, upon the nature of their contract.

The default clause of the lease between Petitioners and the Debtor, quoted above at page 2, is similar to that construed by this Court in *Brown* v. *Irving Trust Co.* (*Manhattan Properties* case), 291 U. S. 320, 338. On similar facts the Court there concluded that the bankruptcy of the lessee did not of itself terminate the lease, that the lease was terminated by the landlord's re-entry, that this re-entry brought to life the contract of indemnity, that the bankruptcy of the lessee did not breach the contract of indemnity and that by its terms no liability would arise on the contract of indemnity until the expiration of the original term. These views are reaffirmed in *Miller* v. *Irving Trust Co.*, 296 U. S. 256, where the Court took the position with regard to a claim based on a similar covenant that, until the expiration of the original term, it would be a mere matter of speculation whether any liability ever would arise.*

Not only may rental values be so enhanced that the landlord will suffer no ultimate loss, but the right to indemnity may be altogether lost or forfeited by any one of a number of contingencies, none of which is by any means remote, to wit, occupation of the premises by the landlords for their own purposes (*Cannon* v. *56th Street Garage, Inc.*, C. C. A. 2d, 45 F. [2d] 110), voluntary transfer of the premises by

* The *Miller* case dealt with a lease of New Jersey premises.

the landlords (*Seidlitz* v. *Auerbach*, 230 N. Y. 167, 175), condemnation of the landlords' property by public authorities, or loss by the landlords of their property through mortgage foreclosure or sale for taxes.

If it is a mere matter of speculation whether any liability will ever arise under the agreement which is to be terminated by the reorganization decree, it is reasonable that Congress should place a limitation upon any compensation to be paid for the termination of the possible liability. The degree of the contingency of the liability obviously depends upon the length of the term of the contract and upon many other factors. It was not desirable, therefore, that Congress should attempt to lay down fixed rules for the determination of the compensation to be awarded, but rather that some limitation should be placed upon the damages which might be assessed and that rights against the Debtor should be speedily adjusted with a minimum of litigation.

The Petitioners, by the covenant inserted in the lease in their interest, expressly excluded the right to *damages* for the breach of the lease and elected to rely on indemnity against loss even in the case of the bankruptcy or insolvency of the lessee corporation. The Petitioners' right depends on the adequacy of the covenant (*Gardiner* v. *Butler*, 245 U. S. 603, 605). Damages in the measure sought by the Petitioners bear no relation to the liability assumed by the lessee. The covenant is to indemnify against loss of rent, and, at common law, future rents are not susceptible of commutation and conversion into present debts (*Jersey Blvd. Corp.* v. *Lerner Stores Corp.* [Ct. of App. of Md., 1936, not yet officially reported], 178 Atl. 707). Granting that the right of claimants under such a covenant should be recognized in a reorganization, it was fair to place a limitation upon the speculative damages which might be assessed, growing out of the "attempts of parties in interest, assisted by experts, to read the future." It was not the intention of Congress that the Debtor should be penalized by the imposition of liabilities not assumed by it. Nor is it desirable or practicable to reserve rights based upon such contingent contracts. In many cases, new money must be raised for the

purposes of the reorganization by the assessment of stockholders, and the parties advancing money to the reorganized company should be apprised of the extent of that corporation's liabilities.

Petitioners must strain to present a picture of a capricious and harsh statute. The very changes made by the Senate and House Committees in the provision under attack indicate deliberation upon the fair compensation to be awarded to claimants such as the Petitioners. To allow, as in this case of a net lease, damages equal to the unpaid rent and taxes to date of re-entry plus rent and taxes payable for a period of three years thereafter is indeed to allow damages in a measure which parties making a new lease might regard as unduly harsh to the tenant.

"Section 77-B is based on equitable recognition of the rights of all who have an interest in a common property * * *." "Like other constitutional grants of power, that giving Congress power over bankruptcies is to be interpreted, not in the light of the conditions with which the framers of the Constitution were familiar, but of what is required under modern conditions to deal adequately with the relationship existing between embarrassed debtors and their creditors." "The statute is of a remedial character, designed to facilitate the reorganization of corporate business made necessary by the economic depression through which the country has been passing." "It is * * * no ground of constitutional objection that the Act relates only to corporate debtors." * "Every member of a political community must necessarily part with some of the rights which, as an individual not affected by his relation to others, he might have retained." (*Cont. Ill. National Bank & Trust Co. v. C., R. I. & P. Railway Co.*, 294 U. S. 648, 674.) If, under the bankruptcy clause, Congress may deal with debtors' rights as well as creditors' rights, the statute should be sustained. All contracts are made subject to such bankruptcy power.

Whether the statutory limitation is applicable in a case where the parties to the lease have stipulated liquidated damages for breach of a lease which may exceed three years'

* The language quoted above is from the opinion of the Circuit Court of Appeals for the Fourth Circuit in *Campbell* v. *Alleghany Corp.*, 75 F. (2d) 947, cert. den. 296 U. S. 581.

rent, we do not undertake to say. No cases are shown to be now pending involving such question. As Judge Hand points out, to challenge a statute one must suffer a personal grievance (R. 154). We suggest, however, that Congress has the *power* under the bankruptcy clause to disregard a measure of damages fixed by the parties if that measure would work an unequal distribution, even though the provision would not otherwise be regarded as one stipulating a penalty. The exercise of such power might result in impairing contracts to different extents, but in nearer equality of compensation.*

There can be no division of the claim by allowing a part and reserving a part. The claim is indivisible (*Hermitage* v. *Levine*, 248 N. Y. 333, 338). Neither may any portion of the claim be reserved for consideration in connection with a plan of reorganization, a suggestion made by some landlords in order to obtain a trading advantage in connection with negotiating a plan. The District Court answered this suggestion, saying that in "a proposed reorganization it is essential that claims be known and fixed at an early date."

CONCLUSION.

We submit that the order appealed from should be affirmed.

Respectfully submitted,

SANFORD H. E. FREUND,
WINTHROP H. KELLOGG,
DOUGLAS B. STEIMLE,
Counsel.

SHEARMAN & STERLING
AND
BERLE & BERLE,
Attorneys for Preferred Stockholders Protective Committee.

---

* That the instant case is the only one so far reported in which the constitutionality of the limitation has been contested, despite the great number of reorganizations involving leases, indicates that the statute provides a practical means of adjusting landlords' claims.